IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE NO. 88 OF 1996

For Approval and Signature:

HONOURABLE MR.JUSTICE R.S.GARG

HONOURABLE MR.JUSTICE D.H.WAGHELA

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the Civil Judge?

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ARUN FAMILY TRUST - Applicant(s)
Versus
COMMISSIONER OF INCOME TAX - Opponent(s)

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Appearance :
MR. H.M. TALATI for Applicant(s).
MR. MANISH R. BHATT for Opponent(s).

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CORAM : HONOURABLE MR.JUSTICE R.S.GARG
and
HONOURABLE MR.JUSTICE D.H.WAGHELA

Date : 20/09/2006

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE R.S.GARG)

The Income Tax Appellate Tribunal, Ahmedabad Bench “A”, in the matter of Income Tax Appeal Nos.1520 &

1521/Ahd/90 relating to Assessment Years 1985-86 and 1986-87, has referred the following question under Section 256(1) of the Indian Income Tax Act, 1961 (“the Act” for short) for the opinion of this Court:

> *“Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the interest paid to the beneficiaries was the income of the applicant-Trust and the applicant-Trust was not entitled to a deduction of the same?”*

2. The short facts giving rise to the present matter are that during the assessment proceedings for the Assessment Year 1985-86, the Assessing Officer observed that the Assessee-Trust had credited an amount of Rs.44,030/- on account of interest to the account of the beneficiaries and claimed deduction thereof. He called for the explanation and after rejecting the same, added the said amount of Rs.44,030/- to the income of the Trust and accordingly, taxed the Trust. The Trust, all through, had been submitting that the Trust was a specific Trust with six minor beneficiaries, having definite share and that only two Trustees were given absolute power to possess the amount standing to the credit of the said six beneficiaries with further power to spend accumulations for maintenance, support, education, advancement, etc.

till dissolution of the Trust. It had been all through submitted by the Assessee that the Trust was settled in the interest of the beneficiaries and the Trust was to enter into the business and the income so earned by the Trust was to be distributed equally between the beneficiaries.

2.1 It is also the case of the Trust that the net income has to be divided equally and is to be paid in cash to the beneficiaries or in the alternative, a credit could be made in the accounts of the beneficiaries and such credit would amount to payment. The submission of the Trust all through had been that as the money accredited in the accounts of the beneficiaries was not withdrawn by the beneficiaries, the same remained with the Trust, it was treated as a loan and the Trust was paying interest to the beneficiaries and in such a case, the Trust was entitled to claim deduction to such an extent. The Assessing Officer, the Commissioner of Income Tax (Appeals) and the Tribunal all had been in lines in observing that the interest paid to the beneficiaries could not legally be claimed as deduction because there was no loan transaction between the parties. The Tribunal also held that there was no privity of contract amongst the beneficiaries and the Trust so far as the transaction

of borrowing is concerned as the beneficiaries were not having any control over their income till it was absolutely transferred to them. The Tribunal also held that the Trust cannot be allowed to allocate interest to the beneficiaries when they have not actually paid any amount to the beneficiaries except making a book entry which was not going to vest any right in the beneficiaries for utilisation of the amount so far as so passed under those book entries.

3. Shri Talati, learned Counsel for the Assessee, placing his strong reliance upon the judgement of the Division Bench of this Court in the matter of ***Commissioner of Income-Tax vs. Tanvi Sajni Family Trust***, [(***1994***) ***209 I.T.R. 497***], submitted that if the money was treated to be loan and interest was paid on the same, then, no wrong could be found in the action of the Trust and the Trust was entitled to claim deduction of the amount of interest paid.

4. It was also submitted that from the terms of the Trust Deed, it would clearly appear that the Trust was entitled to raise loans, use and utilise the said amount for earning more and was also entitled to pay interest on the loan amount. His submission is that if

the money is accredited in the account of the beneficiaries and was not actually withdrawn by them, then, the same could be treated to be the loan from the side of the beneficiaries to the Trust and the Trust would be justified in paying the interest on it. The Trust Deed is available on the records. Paragraph-6 of the Trust Deed reads as under:

> *"(6) Trust Fund and its application:*
> *a) The Trustees for the time being of these present shall stand possessed and hold the said sum of Rs.10,000/- (Rupees Ten Thousand Only) and which and such shares, stocks and securities and other investments, business, properties and funds which may under the Trust of these persons be substituted or added in the execution of the said Trust including any donations and any other augmentation, herein designated as the Trust fund.*
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> *b) The said Trustees shall receive and collect all the annual and other income of the said Trust fund and shall from out of the same in the first place pay all the costs, charges and expenses of and incidental to the management, administration and execution of the Trust and powers hereof including any income-tax, wealth-tax or other taxes, dues, duties, impositions imposed by the Central Government, the State Government, the Municipal Corporation or any other competent authority and costs of ordinary repairs to the immovable property,*

if any forming part of the Trust fund.

And subject thereto, the Trustees shall distribute or treat as distributed without actually distributing the same (by crediting to their respective accounts) the balance of the annual or other income or residue into cash or kind in the manner and in the proportions among the Beneficiaries as mentioned hereunder:

	Name	Share
(1)	*Arunkumar Popatlal Thakkar*	*10 np.*
(2)	*Smitaben Popatlal Thakkar*	*25 np.*
(3)	*Nimaben Popatlal Thakkar*	*25 np.*
(4)	*Hetalben Popatlal Thakkar*	*20 np.*
(5)	*Rakesh Bhailal Thakkar*	*10 np.*
(6)	*Nitinkumar Bhailal Thakkar*	*10 np.*
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		100 np.

c) The Trustees shall during the life time of the said Beneficiaries stand possessed of their respective proportionate share upon trust to apply the income and any accumulations thereof unto and for the maintenance, support, education, advancement and benefit of the said Beneficiaries till the date of dissolution of this Trust and thereafter absolutely transfer to the said Beneficiaries their respective proportionate shares from the assets of the Trust Fund."

From paragraph-6(b), it would clearly appear that the Trustees were obliged to make payment by actually paying the amount or by making book entry without actual payment or without distributing the same.

If such a book entry is made, then, it would be deemed that the amount had been so paid in respect of the accounts of the beneficiaries.

5. Sub-paragraph (3) of Paragraph-11 of the Trust Deed reads as under:

> *"And without prejudice to the generality of the foregoing provisions, the Trustees may invest the Trust fund and/or any other money requiring investment (for which purpose the Trustees may even borrow money from any source including the Beneficiary of this Trust, at such rate of interest as they deem fit, with or without giving security of the Trust fund and on such other terms and conditions as they deem fit."*

From the terms and conditions incorporated in the Trust Deed, it would clearly appear that the money can be paid in cash and loan thereafter can be taken or a book entry can be made and the money in cash can be paid to the beneficiaries at any later time. The Trust Deed does not say that any book entry in favour of the beneficiaries, on non-payment of the amount in cash, would be treated to be a loan from the side of the beneficiaries in favour of the Trust.

6. In the commercial world, there is a pointed

distinction between the deposit and the loan. For the loan, there must be a/an settlement/agreement between the parties that particular amount would be given by one party to another party. The terms would be that it would be refunded or returned either on demand or on the directions of the creditor and particular interest would be paid on the said amount. For the purpose of loan, there must be interaction between the parties and there must be a concluded contract. In case of a deposit, the depositor goes to the other person, gives his money and the Depositee of the money receives the money with a condition that he would keep the money in trust with him and may pay or may not pay any interest on it. In case of the Bank, where the holder of the bank account deposits money, he enters into an agreement with the Bank that he would be entitled to particular rate of interest. In a given case, the Bank may even charge some money from the said depositor for maintaining his account and safekeeping of the deposit money. In case of a deposit, payment of interest would not be a condition precedent. Though payment of interest may not be a condition in case of the loan may be free of interest, but, there must be a creditor and debtor. In case of deposit, the person, with whom the money is to be deposited, can refuse to receive the money, but, in case of loan, the debtor if accepts

the money, then, he would be under an obligation to refund the money with interest as agreed between the parties.

7. In the present case, money by fiction would be deemed to have been paid though it was not so paid. Money continuous to be with the Trust. In absence of a loan transaction or a loan agreement between the beneficiaries and the trustees, the trustees would be treated to be the depositee for and on behalf of the beneficiaries. If the money to be paid is deemed to be paid, but, is actually not received by the depositor, then, the liability of the Trust would come to an end and as a Depositee, it would be answerable to refund and payment in cash. In this case, credit entry was one of the modes of distribution of the profits and that was not the only mode of payment.

8. In the matter of ***Tanvi Sajni Family Trust***, (*supra*), the Court found and we would agree to the observations that the Trust is a distinct legal entity and different from the beneficiaries and therefore, it could not be said that after the money becomes payable to the beneficiaries under the deed as per the determinate shares, it could be treated by the Trust as its own money. True it is that once a book entry is made and the

book entry is deemed to be the real payment, then, the money would remain in deposit with the Trust because they cannot claim the said amount as property or the money belonging to the Trust.

In the said case, the High Court has observed that the beneficiaries were not obliged to keep the amount with the Trust and the fact that they were treated as loan on which interest was payable by the Trust, cannot go against the Assessee. In the present matter, in absence of an agreement between the parties or a direction from the beneficiaries that the amount deemed to be paid still lying with the Trust, be deemed to be loan, the deposit would continue to be deposit. It would become a loan transaction only if there is an agreement between the parties.

9. In the present case, the Trust has not come out with the case that the amount was to be paid in cash, their case is that it was paid in the form of a book entry and as the money remained with the Trust, they were entitled to treat it as loan. We are unable to accept this explanation. There is no agreement between the debtor and the creditor. One cannot say that he would pay particular rate of interest or particular interest on

particular amount, which he receives from somebody even in absence of the agreement. We do not know what was the agreement between the parties because the same has not been brought on record. The Tribunal was justified in holding that the interest paid to the beneficiaries could not be claimed as deduction and as a fact, it was the income of the applicant-Trust. The question is answered in favour of the Revenue. The Reference stands disposed of accordingly. No costs.

[***R.S.Garg, J.***]

[***D. H. Waghela, J.***]

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